

Risk Management

Fast institutional growth and the impact of the global financial crisis have sharply increased the need of financial institutions to strengthen their risk management systems in order to better identify, assess and control risks. However, few micro lenders have a comprehensive risk management framework in place today. This is in particular true for the management of operational risks, which are normally assigned to different departments, making controlling them more complex.

BFC's Approach

BFC has a flexible approach towards microlending risk management that takes into account the diverse needs of its client institutions.

BFC therefore offers two organizational models to effectively implement risk management:

1. Centralized risk management is recommended for large institutions and those with aggressive growth plans. Risk management is performed by a specialized unit, making reporting and supervision less complex for the management and board.



PROJECT REFERENCE

Strengthening of Credit Risk Management Function

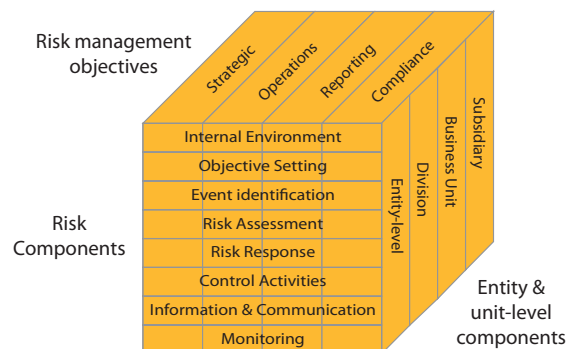
Client: Large MFI
 Country: Romania
 Financing agency: EBRD
 Duration: 7 months
 Impact: BFC supported the institution in improving its credit risk and portfolio management, redesigning credit approval processes, and implementing effective recovery procedures.

2. Decentralized risk management is the more cost efficient option. The responsibility for operational risk management is assigned to several departments.

For both options, BFC's input includes the following:

- analysis of current risk management capacity
- staff training
- implementation of improved risk management procedures

BFC's work fully incorporates the standards set by the COSO Enterprise Risk Management Framework:



Risk Management

Product Components

Credit Risk Management

Only a few institutions have a comprehensive portfolio risk management approach. In the wake of the global economic crisis, proper portfolio risk management practices have become critical for institutional survival. BFC uses its experience to assist institutions in managing transaction and portfolio risks.

Solutions offered by BFC address the following areas:

- lending policies
- credit process
- loan approval
- monitoring
- loan workout

BFC offers its clients the following tools to improve credit risk management:

Risk Based Internal Audit

Risk Based Internal Audit analyses not only the procedural compliance aspects of business processes, but also the extent to which policies themselves are appropriate.

(see BFC's separate information sheet on Risk Based Internal Audit for more information)

Credit Scoring

BFC develops internal rating tools to standardize and automate the credit risk assessment process. BFC's approach is based on complementing the expertise of the lending staff with automated risk rating.

(see BFC's separate information sheet on Credit Scoring for more information)

High Risk Client Relationship Management

High risk clients are customers who have, or might soon have, problems servicing their debts. Most institutions treat these clients as a homogenous group and use traditional workout procedures. However, recent declines in portfolio quality worldwide have made it vital for microcredit institutions to adopt a more structured approach towards this challenging client segment.

BFC supports lenders by segmenting problematic clients based on the probability of repayment. BFC then works with institutions to develop the specialized staff skills and procedures needed to assist borrowers with keeping on top of their repayments. Only clients that do not meet mutually agreed performance goals are passed on to the traditional loan workout structures. This two way strategy allows institutions to manage and control their portfolio risks more efficiently.

Operational Risk Management

After years of fast growth, improving Operational Risk Management capacity has become a priority for many lending institutions concerned with transaction risks, fraud risks, and legal and compliance risks.

BFC reviews organizational structures and procedures, human resource management and MIS and analyzes their ability to control operational risks, prevent fraud and error, and enable appropriate monitoring and control. Depending on the needs of its client, BFC follows up by consulting on structural and procedural changes, or by directly training staff.

Asset & Liability Management

Decreasing loan portfolio quality, delayed repayments and reduced access to funding in the wake of the global financial crisis has alerted many lending institutions to the need to optimize their Asset & Liability Management capacity. Investors are paying increasing attention to the issue, and are beginning to make sound Asset & Liability Management a key precondition for future funding.

BFC works with its clients to improve their management of liquidity, interest rate and currency risks. BFC advises institutions on effective tools and procedures for managing these risks. In addition, BFC provides tailored training to key staff to overcome bottlenecks in financial management capacity.

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